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SUBJECT: CHINA ANNOUNCES SHIPBUILDING SUPPORT PLAN

REF: (A) Beijing 151; (B) Beijing 326; (C) Beijing 425

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¶1. (SBU) SUMMARY. China's State Council announced a shipbuilding industry support plan on Feb. 11, the fifth of ten such plans for key industries designed to help sectors hit hardest by the economic slowdown. The plan includes a three-year moratorium on approval of new shipyards, but observers doubt industrial capacity will level off for several years. An initiative to promote industrial consolidation may be difficult given the growing role of regional and privately owned firms. Measures to enhance firms' research and development capabilities and to offer export credits to foreign ship buyers will be watched closely for signs of subsidies. Conversion of shipyards to repair facilities may be a gesture to help private shipbuilders, but the bulk of the plan appears aimed at large state-owned firms. With the industry heavily dependent on exports, there is some concern domestic measures may not be enough to make up for the fall in external demand. Chinese shipyards have strong order books, but they have not been forthcoming about the status of those orders in the wake of an economic downturn that has torched many other deals. END SUMMARY

¶2. (SBU) The State Council approved a new support plan for the Chinese shipbuilding industry on Feb. 11 - the fifth of ten plans for key industries. (See reftels for reporting on autos, steel, textiles and machinery. Reporting on other sectors is forthcoming.) The announcement emphasized that the shipbuilding industry is important not only because it supports the nation's transportation infrastructure, but also the development of the related steel, chemicals, machinery, and information technology industries. The plan seeks to maintain existing ship orders; support development of the industry by reducing risk; limit new capacity and strengthen the position of large shipbuilders; accelerate indigenous innovation and increase the added value of projects; and develop maritime engineering projects in addition to traditional shipbuilding.

¶3. (SBU) As announced, the support plan will seek to:
(1) provide credit and financial support to large shipbuilders and shipping companies to stabilize existing orders, fulfill contracts on time, and arrange for purchases of abandoned ships;
(2) accelerate scrapping of old ships and single-hulled tankers to stimulate demand for new ships; and develop ocean-going, special-purpose, engineering and repair ships and expand market share of hi-tech ships and maritime engineering equipment;
(3) support the research and development (R&D) efforts of firms for maritime engineering equipment, such as self-rising platforms and motors and engine systems;
(4) support the expansion of the ship repair business via current facilities, especially for large vessels, special purpose ships and maritime engineering projects; and regulate development of the ship scrapping sector;

(5) encourage mergers and acquisitions among ship-building enterprises and alliances of up and down-stream suppliers and provide guidance to small and medium-sized shipbuilding enterprises on business structure; and
(6) strengthen technical innovation to upgrade indigenous technical capability, optimize and upgrade cargo and container ships and oil tankers, and raise R&D ability in high-tech, high value ship design to meet domestic needs for energy-saving vessels and maritime engineering projects.

A MORATORIUM ON NEW CAPACITY

¶4. (SBU) Specific measures included a three-year moratorium on the approval of new ship-building projects and capacity expansion through 2012. Other details include expanding bank credit for buyers of exported ships; special credit lines for domestic purchase of ocean-going ships through 2012; drafting policies to encourage early retirement of old ships and single-hull oil tankers; arranging a special fund for technical innovation; and supporting the R&D efforts for hi-tech ships and maritime engineering projects. The measures did not include a change in rebates of value added tax (VAT) for exports, since shipbuilding already receives the maximum 17 percent.

INDUSTRIAL STRUCTURE: HOW DID WE GET HERE?

¶5. (SBU) China's shipbuilding industry has been dominated by two state-owned conglomerates: China State Shipbuilding Corporation (CSSC) and China Shipbuilding Industry Corporation (CSIC). A second tier of firms includes shipyards affiliated with the largest

state-owned shipping companies - COSCO, China Shipping and Chang Jiang. With rapid growth, the industry developed a third tier of new firms: (1) provincial and municipally-owned shipbuilders; (2) large-scale private firms, such as Rongsheng Heavy Industries; and (3) nearly 3,000 "shatan" or beachfront shipyards, up tenfold from a decade ago. In mid-2008, it was Rongsheng from this third tier which shocked the industry with a huge order for 12 bulk cargo vessels from Brazilian iron ore exporter Vale do Rio Doce. The 400K DWT ships will be the largest ore carriers in the world and the largest ships ever built by China.

¶6. (SBU) Overall, 2008 was a good year for the China shipbuilding industry. According to Cao Yousheng, Vice-Chairman of China Shipping Industry, the country had 28 million DWT of finished production in 2008, double the level in 2006 and equivalent to 30 percent of the world total. The industry received 58 million DWT of new orders during 2008 (down from a peak of new orders in 2007), and exports surged 60 percent over 2007 to $19.1 billion. Booked ship orders overtook Japan for the first time, and shipbuilders' profits rose 50 percent to USD 4 billion.

INDUSTRY NOT FORTHCOMING ON ORDER STATUS

¶7. (SBU) But with 80 percent of production exported, the industry is highly dependent on external demand. The economic slowdown began to hit the shipping industry in mid-2008, and reverberated through the shipbuilding sector as charters were taken out of service and leasing companies began to cancel or delay ship deliveries. Chinese shipbuilders and shipping companies were reluctant to publicly reveal cancelled orders, in some cases over concerns about upcoming IPOs or struggling stock prices in an already weak market. By early 2009, Singapore Pacific Basin Shipping reported that 382 ship orders had been cancelled worldwide, with China accounting for half or roughly 20 million DWT, and new orders had practically come to a halt.

HOW MUCH CAPACITY IS TOO MUCH?

¶8. (SBU) As with other key industries, China's shipbuilders have been rapidly expanding capacity. The 2006 National Medium/Long-Term

Plan for the Shipbuilding Industry set the goal to become the world's largest shipbuilder by 2015. State-owned companies had access to cheap credit, provincial and municipally-owned firms received local government support, and in a growing market private firms expanded using down payments on new orders. Given the long lead times on such facilities, even with the announced moratorium on new approvals it may take years for production capacity to level off. A Shanghai analyst noted the expansion curb would only control capacity in the medium to long-term. China's current capacity is estimated at 60 million DWT, more than double 2008 production.

ROAD AHEAD STILL HARD TO EVALUATE

¶9. (SBU) Guangzhou Shipyard and CSSC shares both rose 10 percent on news of the support plan. According to China Shipbuilding Industry Association, booked orders had reached 205 million DWT in 2008, 38 percent of the world total. The industry expects 20 to 30 million DWT in new orders in 2009. While these figures appear to indicate a healthy buffer to weather the downturn, the lack of transparency makes it difficult to assess the industry's true status. China's rapid growth came from bulk cargo and container ships, which are bearing a larger share of cancellations. 2009 orders are likely to favor oil tankers, especially very large crude carriers (VLCC), a field where China does not have a strong advantage. Private shipbuilder Rongsheng announced a USD 2 billion IPO last August, but this February said the deal has been delayed indefinitely. The company reassured markets that its USD 1.7 billion deal with Vale had not been cancelled.

¶10. (SBU) COMMENT. The latest support plan again raises a lot of questions. Some provisions appear to be at cross purposes, namely accelerated scrapping of old ships while promoting the ship repair business. Money may not be enough to achieve technical innovation, and both government support for R&D and the new export credits will be closely watched by foreign competitors concerned about subsidies. . Industry consolidation makes economic sense, but the state-owned sector is already highly concentrated and it will be hard to force mergers of third-tier producers. It will take more than a moratorium on approvals of new facilities to address shipyard overcapacity. Reports that this is yet another boost to the steel industry are doubtful since domestic shipbuilding consumes only five to six million tons of steel per year, while China produces nearly

500 million tons. END COMMENT.

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